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WEEKLY INVESTMENT LETTER

May 6, 1946

THE KROGER COMPANY

The Kroger Company ranks second in the number of stores operated and third in sales volume among retail food chains. At the end of 1945, it had 2,730 stores and in that year sales reached \$457,332,640. Reflecting a trend in this branch of merchandising towards fewer but larger units, the number of Kroger stores has decreased steadily for many years and the present number is less than 2/3 the number at the end of 1935. Over the same period, however, weekly average sales per store nearly tripled to over \$3,000 last year. In the same ten years, total sales grew to nearly double the 1935 figure, while net income before federal taxes on income reached \$15,645,826 or 3.8 times the figure for the earlier year. The margin of profit before taxes on income increased over the preceding period in six of the ten years, with the highest margin shown in 1945. Earnings per share fell far short of keeping pace with this increase, barely exceeding in 1945 the results for 1939, but this was due principally to much higher rates of taxes on income.

An attribute of this industry is flexibility in being able to shift sales effort from products in short supply to substitute or different products. During the war the management seems to have shown considerable ability in this respect.

The company's stores are located in eighteen states mainly north of the Ohio and east of the Mississippi rivers. They carry complete lines of groceries, vegetable, fruit and meat, while some larger self-service stores carry also numerous specialties of the delicatessen class. While some of the stores are of the latter type, the company's development along this line has been limited to locations where there is promise of higher volume and profit. According to sources close to the company, almost all of the company's stores are held on short term leases.

A large volume of products is manufactured or packaged under the trade names of "Country Club" or "Avondale" for canned or packaged goods; "Latonia Club" for carbonated beverages; "French" and "Spotlight" for coffees; "Clock" for bread and "Embassy" for condiments. One or more manufacturing plants, in many cases owned in fee, are located in each of nineteen cities. They include bakeries, dairies, meat processing and coffee roasting plants.

Kroger, jointly with Westinghouse Electric Corporation, developed and owns a patented process called "Tenderay" for tenderizing meat. By this process the usual "hanging" for considerable periods essential to make meat tender, is accelerated and in addition it is claimed that a better final product is obtained than is possible by traditional methods. Development of use of the process was retarded during the war by shortages of equipment, but expansion possibilities seem impressive.

During the last sixteen months, Kroger sold at a profit the three meat packing plants which it owned but which yielded only a small profit margin. Meat processing and distributing plants are being retained. For some three years it has been developing frozen food lines and acquiring mobile quick-freezing units and other equipment. The management considers that it is well situated in this field, with further progress in view.

The company has for many years emphasized personnel values. The success of its efforts in this direction appears to be shown by the return to it of upward of 75% of former employees who have been discharged from the armed services, as well as by labor efficiency which a source close to the management says is at or above prewar levels. Labor difficulties have been minor and employees generally are not unionized.

Kroger's capitalization is simple, consisting of 1,836,589 shares of common stock with a negligible amount (\$96,000) of preferred stock. At the end of 1945, current assets were \$66,848,863, which included \$19,737,033 cash, while current liabilities were \$27,513,202.

(OVER)

THE KROGER COMPANY
(Continued)

The company has plans for expansion but limitations on construction probably will restrain capital outlay to amounts which can be provided from operations.

<u>Years</u>	<u>Stores</u>	<u>Sales</u> (In Thousands)	<u>Net Income</u> (In Thousands)	<u>Earned</u> <u>Per Share</u>	<u>Dividend</u>	<u>Price Range</u>
1945	2,730	\$457,333	\$5,643	\$3.07	\$2.00	50 1/8 - 37
1944	2,896	448,381	5,144	2.80	2.00	37 1/2 - 31 1/2
1943	2,999	422,428	5,009	2.72	2.00	32 3/4 - 24 7/8
1942	3,174	388,847	4,649	2.53	2.00	29 1/2 - 22 1/8
1941	3,477	302,766	4,970	2.71	2.00	29 7/8 - 24
1940	3,727	258,115	4,607	2.51	2.00	34 1/2 - 23 1/2
1939	3,958	243,357	5,515	3.02	2.50	29 5/8 - 20 1/4
1938	3,992	231,296	3,742	2.05	1.90	21 5/8 - 12 3/8
1937	4,108	248,444	2,950	1.62	1.60	24 1/4 - 14
1936	4,212	242,273	3,488	1.91	1.90	28 - 19 3/8

As indicated by the above figures, growth of sales in recent years has been relatively steady. Net income growth has been affected during the last four years by heavy taxes on income. If the now effective 38% rate of federal income tax were substituted in the 1945 earnings for the tax charge actually made, the reported earnings of \$3.07 per share would become about \$5.25 or substantially higher than in any previous year. Taking account of the expected high general purchasing power and the possibility of higher prices, higher volume and earnings in excess of this adjusted figure appear in our opinion, quite possible. We believe that income from licensing the "Tenderay" process also ultimately may prove substantial.

The common stock currently sells at about 60 (1946 range 61 3/4 - 44 1/2). Dividends presently are being paid at a rate of \$2 annually. Generally, we expect the company to continue to pay a reasonable proportion of its earnings in dividends. Dividends have been paid in each of the forty-four years since organization in 1902.

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Information given in this memorandum, excluding opinions, which are our own, has been obtained from reports, statements and comments published by the company, Moody's Investors Service, Standard & Poor's Corporation, Dow Jones & Co., and other sources mentioned, and is necessarily not all inclusive. For additional information concerning the affairs of this company we refer you to these sources. Butcher & Sherrerd has no interest in the stock of this company and this memorandum should not be considered as an offer on our part to sell this stock.